Latvia

Introduction

Latvia is the poster boy of the IMF – praised for tackling its budget deficit and returning to growth. The reality however, is far from the spin of the pro-austerity brigade. Dubbed ***internal devaluation*** or *competitive austerity* Latvia had just one blunt instrument in response to the global financial crisis; push down spending and wages through mass unemployment in order to make the country more 'competitive'. This was despite the fact the government's debt was extremely low. The debt causing a problem was that of the banks and their Scandinavian owners.

Origin of debt crisis

After gaining independence from the Soviet Union in 1991, Latvia's economy crashed as Soviet demand for its exports dried up. The economy began to recover in 1994, but, in 1995, fraud and bad loans by Banka Baltija led to a banking crisis.

Steady economic growth in the late 1990s and early 2000s saw unemployment gradually falling. In 2004, Latvia joined the EU and as part of the process of accession all controls on the movement of capital in and out of the country were removed. With the Lat tied to the Euro from 2005, Western banks were given confidence in the Latvian economy and large amounts of loans flooded into the country through the banking sector, particularly from Scandinavian banks. Four banks came to dominate the economy with 75% of the lending – Hansabanka (owned by Swedish Swedbank), Parex Banka, SEB Banka (Swedish) and Nordea (Scandinavian-owned bank listed in Denmark, Finland and Sweden).

The loans funded the purchase of assets such as property and increased consumption, fuelling a boom. However, inequality also increased. In 1998, for every €1 earned by the poorest 10 per cent, the richest received €14. By 2008, this had increased to €17.[83]

Between 2005 and 2007, the foreign-owed debts of the private sector rose from $14 billion (90% of GDP) to $37 billion (130% of GDP). Throughout the boom public sector debt remained extremely low, with government external debt at 5% of GDP in 2007, and total public debt at 9% of GDP.

When the global banking crisis erupted in 2008, foreign loans effectively ended, and the debt led to a net drain of resources out of the country. Lacking the foreign loans which had funded the boom, the economy crashed. Between late 2007 and late 2009, Latvia's economy shrank by about 24%.[84]

Parex bank went bust. Rather than allowing foreign creditors to pay the price for their **reckless lending**, the Latvian government bailed out the bank, to the tune of 1.2 billion lats[85] ($2.2 billion) to enable the bank to keep paying its creditors. This bailout was partly funded by loans from the IMF and EU to the Latvian government.

Despite having low public sector debt, large cuts in public spending and increases in taxation were introduced, with the aim of forcing down wages and consumption, to make the country 'competitive'. Unemployment increased to 20% by 2010. Taking account of people involuntarily working part-time, and those who had given up looking for work, underemployment reached 30% in 2010.

It is estimated 200,000 people have left the country seeking work elsewhere; one-tenth of the population (the equivalent of 6 million people leaving the UK). More than 12% of the overall population now works abroad and specialist workers are in short supply.

Government external debt:
- $9.5 billion
- 33% of GDP

Private external debt:
- $30.3 billion
- 107% of GDP

Government external annual debt payments:
- $625 million
- 6% of revenue
- 4% of exports

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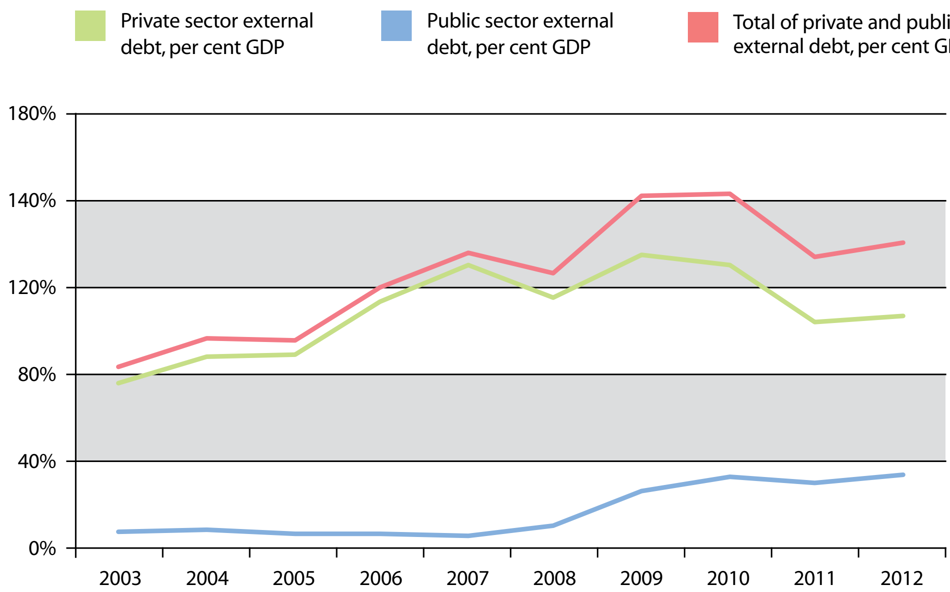

In the run-up to the global financial crisis, the increase in Latvia's external debt was entirely due to borrowing and lending by banks, not the government. Even having gone through a huge crisis, government debt is still far lower than in other European crisis countries.

Figure C8.1: Latvia external debt (per cent of GDP)[86]

Austerity has created demographic losses exceeding Stalin's deportations in the 1940s. With poverty rates rising, the birth rate has declined, meaning Latvia's population is ageing much faster than elsewhere in Europe.

Most of the austerity measures were introduced in 2009, when the economy collapsed far more dramatically than predicted by the IMF. When agreeing the lending programme in 2008, the IMF had expected the economy to contract by 5% in 2009; in fact it fell 17%. Unemployment had been expected by the IMF to increase to 9%; in reality it reached 17%. In 2010, Latvia failed to adopt the further cuts demanded by the IMF.[87]

Life and debt in Latvia

Latvia's austerity programme was brutal and front-loaded. 15% of GDP was cut over three years but around 9% in 2009 alone. Public services – especially health and education – have borne the brunt of massive **spending cuts**. In late 2008, 10% of public sector staff were dismissed. The number of health workers fell by 2,700 – a loss of 8%. 115 schools (12%) were closed, with school staff falling by 14%. Through the course of the IMF programme, the number of civil servants was cut by 30% and public sector salaries fell by 40%.

Spending on **education** fell 25% in 2009 compared with 2008. In 2009–2010 Latvia fired one-third of its teachers. To make matters worse pay cuts of almost one-third were forced on teachers in September 2009, with gross monthly wages plummeting from €494 to €358. Pension entitlements were slashed.

Rocketing unemployment led to a drastic **fall in wages** across the public and private sectors. From 1 July 2009 wages for public sector employees were cut by between 15 and 20%, while at the same time the level of untaxed minimum earnings was cut by 39%. Public sector wages were slashed three times between mid-2008 and July 2009. Frank Gill, from credit ratings agency Standard and Poor's said in February 2010 that public sector wage packages had fallen around 45% on the year and private sector salaries had fallen between 5% and 30% in just 18 months.

At the same time income **tax** rates increased from 23% to 26% and VAT from 18% to 21% – then later to 22%. There has been a severe worsening of working conditions with an increase in precarious work, collective agreements being ignored, a massive growth in unpaid overtime, greater stress, a growing number of hidden accidents at work and working hours laws being disregarded.

Workers' rights to paid sick leave have been reduced from 14 days to 10.

Further changes to labour laws in 2010 made it easier to sack workers by enabling employers to release employees from their contracts if they have been unable to work for periods of longer than six consecutive months or, intermittently, for a period of one year and three months.

While wage cuts have led to a massive hike in poverty among workers, for those relying on **benefits** the story is just as brutal. In July 2009, child benefit was

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reduced to a flat rate of $8 per family, regardless of the number of children a family has. Stricter qualifying conditions were introduced for unemployment benefit, with payments available for a maximum of nine months. As a consequence, the at-risk-of-poverty rate for the unemployed is now over 50%, according to the European Commission.

Government attempts in July 2009 to enforce cuts in old-age and service **pensions** – which were to be decreased by 10%, and by 70% for working pensioners – alongside plans to axe by half the early retirement pension for people who retire after 1 July 2009, were ruled unconstitutional by the courts. However the government has pushed ahead with plans to increase the retirement age from 2014.

Between 2008 and 2011, the European Commission says the percentage of the Latvian population living with 'severe material deprivation' increased from 19% to 31%, the second highest level in Europe, after Bulgaria.[88] Latvia also experienced a 15% increase in the number of suicides between 2009 and 2012.

Latvia is touted as an IMF success story. It is not. According to the Latvian Free Trade Union (LBAS), the total number of poor people doubled in the first half of 2010. According to investigative news outlet *Re:Baltica*, Latvia has *"the largest wage inequality in the EU"*. Is that what success looks like to the IMF?

"The idea of a Latvian 'success story' is ridiculous. Latvia is not a model for anyone."

ALF VANGAS, DIRECTOR, BALTIC INTERNATIONAL CENTRE FOR ECONOMIC POLICY STUDIES.

Resistance and the demands of activists

The severe deterioration of living conditions as a result of the brutal austerity measures implemented in 2008–2009 led to a surge of **protests** throughout 2009. In January, the largest protest in Latvia's post-independence history was held. In the face of the demonstrations the coalition parties withdrew their support from the government and Prime Minister Ivars Godmanis resigned on 20 February.

But the move failed to quell public unrest and further **demonstrations** against the austerity measures took place, including a series of protests, strikes and work stoppages in the public sector. In particular, the Latvian Police Union organised protests against changes to working practices and wage cuts and doctors took to the streets to demand a halt to cuts in health funding, while teachers and parents protested against cuts to schools and teachers' pay.

On 19 June, the LBAS demonstrated alongside civil society organisations *"For Social Justice – Against Poverty"* outside the Cabinet of Ministers. Protestors demanded a fair tax policy, jobs, employment guarantees for young people, increased pensions and rights to safe and decent working conditions.

Throughout 2010 there were fewer national protests as workers fell victim to rising unemployment and the daily struggle to make ends meet. However, while the industrial struggle ebbed, the LBAS successfully organised a *"no – more austerity, yes – growth!"*

Latvia's unemployment rate shot up to 20 per cent of the labour force following the banking crisis in the mid-1990s. Despite the high growth, it only slowly fell through the 2000s, before increasing rapidly again with the latest banking crisis caused by reckless lending.

Figure C8.2: Latvia unemployment (per cent of labour force, 1992–2012)

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Latvia: health emergency

Latvia is facing a healthcare emergency with hospitals closed, operations cancelled, new restrictions on access to healthcare, longer waiting times and a lack of availability of affordable medicines. Little wonder that mortality rates are now the highest in the EU and maternal death rates are significantly higher than the EU average.

But the crisis is set to get worse. Funding for healthcare in 2013 was the *"smallest in the last decade"* according to the Latvian Free Trade Union. *"This is the cause for large patient payments, long queues for medical assistance, high mortality rate and low doctors' salaries. The government is fine with this, but we are not"* said Valdis Keris of the Latvian Health and Social Care Workers Trade Union.

Health funding has been declining since the IMF austerity programme was launched in 2008. Health expenditure, adjusted for inflation, fell 25% between 2008 and 2010.

26 hospitals, including Latvia's largest – Rigas Prima Slimnca with 650 beds – were closed. 11 emergency care hospitals were shut in 2009. The decrease in hospital admissions led to a sharp increase of women and men with disabilities – 40% more cases per 100,000 inhabitants in 2009 compared to 2006.

The cuts have provoked demonstrations, protests and petitions. Health unions, patients' organisations and disability groups have demanded the government honour its promise to increase funding for healthcare. Thanks to recent campaigns an amendment to the 2013 budget was won, allocating an additional €99.6 million including €34.1 million for healthcare infrastructure.

protest in Riga and four other cities – Liepaja, Valmiera, Daugavpils and Jelgava – followed later that year by a civil society People's Assembly protest against the proposed 2011 budget, which called for no increased taxes on the poor and no more cuts in social welfare guarantees and benefits.

In 2012, the state subsidy to public transport providers was cut by 10%. In June that year, Latvian Passenger Transport Association (LPPA) chairman, Peteris Salkazanovs, announced that passenger carriers intended to call a strike in July 2012 over falling government subsidies – forcing the government to approve a €4.41 million additional subsidy for public transport. Probation workers threatened a strike over a 12-hour cut (from 40 to 28 hours) to their working week and pay – their action secured an improvement to a 36-hour week.

The main focus of protests so far in 2013 has been against government plans to bring forward an agreed rise in the retirement age, from 2016 to 2014. Workers and pensioners' groups are also rallying against a new government proposal that people will have to pay into an insurance scheme for longer – 20 years instead of the current 10, by 2020 – before being eligible for a pension. Campaigners are threatening to trigger a national referendum on the issue.

References – Case study eight

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88 European Commission. (2013). Employment and social developments in Europe 2012. 08/01/13. http://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7315